REPORT OF EXAMINATION

FARMERS NEW WORLD LIFE INSURANCE COMPANY

Mercer Island, Washington

December 31, 2001



States Participating:

Washington Delaware Nevada

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify that the attached Report of Examination shows the financial condition and affairs of FARMERS NEW WORLD LIFE INSURANCE COMPANY of Mercer Island, Washington as of December 31, 2001.

Patrick H. McNaughton
Chief Examiner

July 23 2007
Date

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SALUTATION

Seattle, Washington December 11, 2003

The Honorable Alfred W. Gross Commissioner Commonwealth of Virginia Chair, NAIC Financial Condition (EX) Committee State Corporation Commission Bureau of Insurance PO Box 1157 Richmond, VA 23218 The Honorable John Morrison Commissioner, Montana Department of Insurance NAIC Secretary, Western Zone 840 Helena Avenue Helena, MT 59601

The Honorable Susan F. Cogswell Commissioner, Connecticut Department of Insurance NAIC Secretary, Northeastern Zone PO Box 816 Hartford, CT 06142-0816 The Honorable Mike Kreidler Commissioner, Washington State Office of Insurance Commissioner (OIC) 5000 Capitol Boulevard PO Box 40255 Olympia, WA 98504-0255

Dear Commissioners:

In accordance with your instructions and in compliance with the statutory requirements of RCW 48.03.010, an examination has been made of the corporate affairs and financial records of

FARMERS NEW WORLD LIFE INSURANCE COMPANY of Mercer Island, Washington

hereinafter referred to as the "Company" or "FNWL", at its home office located at 3003 77th Avenue Southeast, Mercer Island, Washington 98040-2890. This report of examination is respectfully submitted showing the condition of the Company as of December 31, 2001.

SCOPE OF EXAMINATION

Pursuant to RCW 48.03.010, this examination covered the six-year period from January 1, 1996 through December 31, 2001. The examination was conducted at the Mercer Island Home Office of the Company by examiners from the states of Delaware, Nevada, and Washington. It was conducted in accordance with statutory requirements contained in the Washington Insurance Code and the guidelines recommended in the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. The Company's operating procedures and financial records were reviewed as considered necessary to ascertain the financial condition of the Company and conformity with the related laws. These matters are discussed in this report. In addition, the examination included identification and disposition of material transactions and events occurring subsequent to December 31, 2001 that were noted during this examination.

The prior examination covered the period from January 1, 1991 to December 31, 1995, and was conducted by insurance examiners from Washington.

INSTRUCTIONS

1. <u>Authorization of Investments</u>

Prior to April 2000, investment reports were always presented to FNWL's Board of Directors in a timely manner. The investment reports for March 1, 2000 through December 31, 2000 were not presented to the Board until the June 7, 2001 meeting. All investments or loans require timely authorization and approval by FNWL's Board or an appropriate committee pursuant to RCW 48.13.340 which states no investment, policy loan, sale or exchange thereof shall be made by any domestic insurer unless authorized or approved by its board of directors or by an appropriate committee. The committee minutes must be recorded and reported to the Board of Directors for approval or disapproval.

The Company is instructed to revise its procedures to comply with RCW 48.13.340 which provides that no investment, sale or exchange shall be made by any domestic company unless authorized or approved in a timely manner by its Board of Directors or by a committee charged by the Board of Directors or the Bylaws with the duty of making such investment, sale or exchange.

2. Notification of Dividends

On January 12, 2001, the Company declared dividends of \$112 million to Farmers Group, Inc. (FGI) and on January 14, 2002, the Company declared dividends of \$115 million to Farmers Insurance Group, Inc., both without prior notification to the Washington State Insurance Commissioner's Office. RCW 48.31B.025(5)(a) states, "Each registered insurer

shall report to the commissioner all dividends and other distributions to shareholders within five business days after their declaration and at least fifteen business days before payment, and shall provide the commissioner with such other information as may be required. . . . "

The Company is instructed pursuant to RCW 48.31B.025(5)(a) to report to the Washington State Insurance Commissioner's Office within five days after declaring dividends and at least fifteen days before payment. The Company indicates that procedures are now in place to comply with this statute.

3. Intercompany Cost Allocation Agreement

To date, the Company has not implemented a written cost allocation and administrative service agreement to cover cost allocations of overhead expenses such as legal, investment and other services, nor has it filed under Chapter 48.31B RCW and its predecessor Chapter 48.31A RCW any intercompany cost allocation and administrative service agreements. The Company has indicated that a verbal intercompany cost allocation and administrative service agreement has been in force for numerous years. Our review indicated the Company has failed to disclose the verbal intercompany cost allocation and administrative service agreement since required in 1971 pursuant to RCW 48.31B.025(2) [and its predecessor RCW 48.31A.060(2)] and WAC 284-18-920, Form B, Item 5. TRANSACTIONS AND AGREEMENTS.

The services performed by Farmers Group, Inc., are required to be "fair and reasonable" as to terms and charges, pursuant to RCW 48.31B.030(1)(a)(i) and (ii). In addition, RCW 48.31B.030(1)(a)(iii) and (iv), requires that expenses incurred and payments received must be allocated to the insurer in conformity with customary insurance accounting practices consistently applied and that the books, accounts, and records of each party to all such transactions must be maintained to clearly and accurately disclose the nature and details of the transactions and to support the reasonableness of the charges or fees.

The Company is instructed pursuant to RCW 48.31B.025(2)(c)(v) to file an amended annual registration statement which adequately discloses the terms and conditions of the verbal cost allocation and administrative service agreement.

4. <u>Investments in Foreign Securities</u>

The Company has investments in foreign countries which exceed the investment levels in foreign securities stipulated in RCW 48.13.180. RCW 48.13.180(1) limits investments in foreign securities to the securities of those countries in which the Company is authorized to transact business (and then only to the extent of its deposit and reserve obligations in that country). RCW 48.13.180(2) limits the purchase of non-U.S. securities to obligations of the Dominion of Canada, Canadian provinces, Canadian municipalities or Canadian corporations.

Foreign securities are not allowed as a miscellaneous investment. To be classified as miscellaneous investment, RCW 48.13.240(1) states the security must not otherwise be eligible for investment and not specifically prohibited by RCW 48.13.270. Investments in foreign securities are eligible under RCW 48.13.180(1) therefore, they cannot be classified as a miscellaneous investment. As of December 31, 2001, the Company had invested \$69 million in foreign securities.

In 2003, subsequent revision of the statute allows up to ten percent of an entity's assets invested in obligations and securities of foreign governments or foreign corporations, if the foreign jurisdiction has a sovereign debt rating by the Securities Valuation Office (SVO) of one (1).

Under this Examination Order, the Company is instructed to treat the foreign securities as admitted assets until December 31, 2003, and at that time will maintain the revised standard of eligibility contained in RCW 48.13.180 as specified under Special Consent Order No. 102. See item No. 3 under "SUBSEQUENT EVENTS" for Special Consent Order No. 102 issued by the Washington State Office of Insurance Commissioner with an effective date of December 31, 2001.

5. ZSLM Trust Notes

The Company reported \$110,000,000 of ZSLM Trust Notes in the bonds section of its Annual Statement for 2001 and designated them as Provisionally Exempt (PE) from NAIC transactional reporting requirements. These notes were acquired by the Company on October 31, 2001 and represented part of the \$330,000,000 note issuance made on December 19, 2000 by ZSLM Trust 2000-A, a Delaware business trust. Security for the notes is an interest rate and currency exchange "swap agreement" between Morgan Guaranty Trust Company of New York and Wilmington Trust Company. Additional security is a portfolio basket consisting of the proceeds from the issuance of the Trust Notes. The assets of the portfolio basket are invested in foreign notes. The Offering

Memorandum and Offering Supplement supporting the notes expressly state the notes are not insured or guaranteed by any of the parties to the underlying trust agreement or its affiliates.

Pursuant to the Statement of Statutory Accounting Principle (SSAP) #43, the Trust Notes are properly classified as loan-backed securities, and not as bonds. The notes were issued by a trust, are secured only by certain pledged assets, and the sponsor and its affiliates have no financial obligation under the instrument. The NAIC's Securities Valuations Office (SVO) guidelines also preclude the notes from being classified as bonds because the note holders can redeem the notes for something other than US dollars. To qualify as a PE asset-backed security, the supporting collateral must be of a variety of specifically-identified notes and receivables contained in SVO guidelines. The supporting collateral does not meet said SVO guidelines and, therefore, the notes cannot be classified as a PE security.

Subject to investment limitations contained in RCW 48.13.273, RCW 48.13.050 permits an insurer to invest in corporate obligations that are secured by adequate collateral, bear fixed interest, and the issuing, assuming or guaranteeing entity meets certain earning criteria. The investment limitations are based on SVO ratings. The notes do not qualify as an allowable corporate obligation because they have not been rated by the SVO and are not guaranteed.

The underlying investment vehicle supporting the notes is an offshore limited liability company of the United Kingdom (UK). This constituted an ineligible foreign investment under RCW 48.13.180 at the time of purchase. In 2003, subsequent revision of the statute allows up to ten percent of an entity's assets invested in obligations and securities of foreign governments or foreign corporations, if the foreign jurisdiction has a sovereign debt rating of SVO 1. In addition, investment in a single foreign country cannot exceed five percent of the insurers' assets. The Company is to treat the notes as non-admitted assets in present and future regulatory filings until such time as the notes would qualify as admitted assets.

The Company's investment in ZSLM Trust notes is not properly classified as a PE security, corporate obligation, or foreign security. FNWL has requested and has been approved to hold the ZSLM Trust notes as an admitted asset under Special Consent No. 100. The Company is instructed to classify the investment as an admitted asset in the Company's Annual Statement until such time as the investment would qualify as admitted under Chapter 48.13 RCW or December 15, 2004 as stated under the provisions of Special Consent Order No. 100. See item No. 2 under "SUBSEQUENT EVENTS" for Special Consent Order No. 100 issued by the Washington State Office of Insurance Commissioner with an effective date of December 31, 2001.

6. Global Custody Rider

As of December 31, 2001, the Company had securities of over \$4 billion in the custody of Chase Manhattan Bank. The Company's Domestic Custody Agreement with the Bank includes a Global Custody Rider which permits the use of sub-custodians who are only subject to the standards prevailing in the local market.

The Global Custody Rider should require sub-custodians to exhibit the same standards of care and to possess the same qualifications that are demanded of the primary custodian, as stipulated in RCW 48.13.455 and defined in RCW 48.13.450, and to encompass the guidance from NAIC literature all of which provides for:

- 1. indemnification for loss of securities,
- 2. obligations of custodial agents,
- 3. duties upon termination,
- 4. examination rights,
- 5. reporting, record-keeping and documentation requirements
- 6. insurance coverage
- 7. limitations on the use of foreign custodians or agents.
- 8. restriction of qualified custodians to clearing corporations or participants in the Federal Reserve book entry system.

The Company is instructed to revise its Custodial Agreement with the Chase Manhattan Bank to require the same standards pursuant to RCW 48.13.455 for both its primary and sub-custodians, or to eliminate the sub-custodian provision if not needed or used.

7. Loans to Agents

At year-end, the Company had loaned \$231,430 to new agents through its intercompany account. This amount is not secured, and per RCW 48.12.020(3), is not an allowable admitted asset. RCW 48.12.020 (Nonallowable assets) states that advances to officers (other than policy loans or loans made pursuant to RCW 48.07.130), whether secured or not, and advances to employees, agents and other persons on personal security only, shall not be allowed as admitted assets.

Since the Company's loans to its agents are not secured by collateral, pursuant to RCW 48.12.020, the Company is instructed to non-admit unsecured loans to agents. Due to immateriality, no examination adjustment was made to the report.

8. Surplus Notes

A \$119,000,000 Surplus Note issued by Farmers Insurance Company of Oregon and owned by the Company matured on October 1, 2001. The Company did not receive the cash until January 18, 2002. SSAP 21, paragraph 8 states, "Receivables for securities not received within 15 days from the settlement date shall be non-admitted and shall be classified as Other than Invested Assets."

Pursuant to RCW 48.05.073, the Company is instructed to non-admit all monies not received within 15 days on securities settlements that remain outstanding as of the date of filing its regulatory financial statements. Non-admission of these monies was not deemed necessary because of the subsequent receipt and settlement, although the Company is instructed in future filings to comply with SSAP 21, particularly when it involves a related party which is subject to the fair and reasonable standards of the holding company statutes.

COMMENTS AND RECOMMENDATIONS

1. SAP (Statutory Accounting Principles) Cash Adjustment

To recognize month-end premiums for PAC (pre-authorized checks), the Company makes a monthly statutory adjustment to cash, even though the premiums are not received in the bank until the next month. At year-end, these premiums are recorded in the Annual Statement as received, but are not included on the bank reconciliation as a deposit received or in transit.

Since this procedure constitutes advance recognition of assets and revenues, which are subject to possible cancellation, it is recommended that the Company recognize premiums when they are actually received.

2. <u>Certificate of Contribution – Interest</u>

On March 8, 2002, the Company received interest on a Certificate of Contribution issued by Farmers Insurance Exchange. The interest was due on March 1, 2002 and therefore, the Company lost use of the money (\$766,833) for 7 days.

Since the Company is obligated to operate for its maximum legal advantage and protect its solvency margin, it is recommended the Company insist on the prompt payment of intercompany interest due.

3. **SVO Ratings**

In the examination of Annual Statement Schedule D, it was observed that the Company had numerous Z ratings on bonds. In addition, there were a few securities that were not rated by the SVO or rated with a W (the NAIC did not find a recognized rating service listing for these securities).

It is recommended the Company research Z ratings on Schedule D and determine the correct rating for the securities and recognize appropriate valuations for all securities on future Annual Statements in accordance with the NAIC's Annual Statement Instructions. In reviewing the 2002 Annual Statement, it was noted that the Company had researched and rated the Z bonds as well as adjusted the value of an impaired security.

4. Board of Directors Role in Company

Significant structural changes occurred in 2000. Outside directors were eliminated from the Board of Directors; finance and audit committees were dissolved; and banking, investment and financial transaction authority was delegated to the parent, Farmers Group, Inc. (FGI). Regular financial, investment, marketing, staff operations, actuarial, MIS, and insurance operations' reports were no longer approved by the Board. Likewise, officers' salaries and a tax sharing agreement between FNWL/FGI were also not approved by the Board. These changes minimized FNWL's power, authority, and control over its affairs.

Since RCW 23B.03.020(g) and (l) empower the Company to make contracts and establish officers' compensation, and since the Company's Board should oversee all important functions, it is recommended that the Board of Directors of FNWL take a more active role in managing the Company in order to effectively exercise those powers.

5. Accrual of Medical Expenses

The Company determined its year-end accrual for medical examination and inspection fees by summarizing the amount spent during 2001 and accruing one week's portion, thereof. This accrual amounted to \$187,390 on December 31, 2001. During an analysis of invoices paid during the first three months of 2002, it was determined that the Company underaccrued for 2001 medical expenses by approximately \$450,000.

This amount was deemed immaterial for our examination, but all liabilities should be recorded as accurately as possible in order to give a true picture of the Company's surplus position. Therefore, it is recommended the Company utilize a more accurate method of estimating or determining this accrual.

HISTORY

The Company was incorporated as a Washington stock insurance company on February 21, 1910, as New World Life Insurance Company. The Articles of Incorporation, as amended, authorize the Company to write general life, general accident insurance, sickness or health insurance business. Policies may include endowments and annuities, insurance against injury, and disability resulting from sickness.

In 1954, Farmers Group, Inc., a Nevada Corporation, acquired a controlling interest in the Company and later changed the name to Farmers New World Life Insurance Company. During 1977 and 1978, Farmers Group, Inc., acquired all of the remaining stock of FNWL. In 1988, ultimate control of Farmers Group, Inc., was acquired by B.A.T., Industries p.l.c. of London, England. In September 1988, the financial operations of B.A.T. Industries, p.l.c. (BAT) merged with Zurich Insurance to form Zurich Financial Services (ZFS) headquartered in Zurich, Switzerland.

MANAGEMENT

Board of Directors

The Company Bylaws state that the business affairs shall be conducted by a Board of not less than five nor more than eleven Directors. The Directors are to be elected at each annual stockholders' meeting and are to hold office for one year.

Sections 25, 26, and 27 of the Bylaws provide that the officers of the Corporation shall be elected by the Board of Directors. Section 17 provides that there shall be an Executive Committee composed of the President and two or more members of the Board of Directors appointed by a majority of the Board. The President may appoint such other committees as he or she deems necessary.

A review of the Minutes revealed significant structural changes to the Board of FNWL. All outside director positions were eliminated on April 20, 2000 and the FNWL finance committee was dissolved soon thereafter. In its place, FGI officers assumed control over FNWL's investment decisions. Directors and officers serving the Company as of December 31, 2001, were as follows:

Directors - as of December 31, 2001

<u>Principal Occupation & Business Address</u>

Constantine Paul Patsis President, Farmers New World Life Ins. Co.

3003-77th Avenue SE Mercer Island, WA 98040

David Allen Demmon Asst. VP & Treasurer, Farmers New World Life Ins. Co.

3003-77th Avenue SE Mercer Island, WA 98040

Kathryn Marie Callahan VP & Actuary, Farmers New World Life Ins. Co.

3003-77th Avenue SE Mercer Island, WA 98040

James Innes Randolph VP, Farmers New World Life Ins. Co.

3003-77th Avenue SE Mercer Island, WA 98040

Michael Walter Keller VP, Farmers New World Life Ins. Co.

3003-77th Avenue SE Mercer Island, WA 98040

Officers as of December 31, 2001

<u>Name</u> <u>Title</u>

John Ray Patton

Vice President & Secretary

Kathryn M. Callahan

Vice President & Actuary

Michael Walter Keller Vice President

M. Douglas Close Vice President & Corporate Counsel

Sharon D. Courlas, MD Medical Director

David A. Demmon Assistant Vice President & Treasurer

Laszlo G. Heredy Assistant Treasurer

James I. Randolph Vice President & Assistant Secretary

Gerald Edward Faulwell Vice President

Constantine Paul Patsis President

Committees as of December 31, 2001

There were no committees as of December 31, 2001.

<u>AFFILIATED COMPANIES</u>

FNWL is a wholly - owned subsidiary of Farmers Group, Inc., (FGI) with the ultimate parent being Zurich Financial Services Group (ZFSG). As a member of a holding company system, holding company statements are required to be filed pursuant to Chapter 48.31B RCW. Farmers Group, Inc., filed on behalf of FNWL for each of the years under examination.

Affiliated with the life insurance entity and also wholly-owned by Farmers Group, Inc., are several entities which collectively operate as the Farmers Insurance Group of Companies (FIG), the third largest property/casualty insurer in the United States. Included in this group are property and casualty entities Truck Underwriters Association, the attorney-in-fact for Truck Insurance Exchange, and Fire Underwriters Association, attorney-in-fact for Fire Insurance Exchange, both are inter-insurance or reciprocal exchanges. Truck Insurance Exchange specializes in underwriting commercial package policies, commercial vehicle insurance, workers' compensation, inland marine, general liability, burglary and related coverages, hospital and medical professional liability insurance and fire and allied lines on commercial risks. Fire Insurance Exchange handles property insurance for selected dwellings and commercial risks, as well as inland marine and glass coverage. Whollyowned by one or more of the exchanges are several domestic stock property/casualty companies operating within the group structure. These entities also operate in various phases of the property/casualty insurance field and were primarily established to handle business in the companies' respective states of domicile.

Farmers Group, Inc., also manages the operations of Farmers Insurance Exchange (FIE); Mid-Century Insurance Company (MCIC), a property company underwriting all forms of coverages; and Farmers Texas County Mutual Insurance Company, a mutual insurer of mobile homes, motorcycles and non-preferred automobile risks in Texas.

Other non-insurance entities in the group include Prematic Services Corporation, which provides a monthly list bill for an individual or business customer's complete insurance package (from one or more of the group's members); FIG Leasing Co., Inc., a company formed to acquire and own private passenger cars of the member companies in the Group; FIG Holding Company, the owner of the majority of operating real estate of the Farmers Insurance Group of Companies; and Farmers Security Company, an insurance broker formed to conduct loan and finance operations, to register and acquire leases and to buy and sell securities in the open market.

CORPORATE RECORDS

Minutes of the Board of Directors of FNWL and Stockholder meetings as approved, were reviewed for the period covered by the examination. No changes were made to the Articles of Incorporation or Bylaws during the period.

Conflicts of Interest

The Company has an established conflict of interest notification procedure for its directors, officers and responsible employees. Each submits a signed conflict of interest statement to the Chair of the Executive Committee on an annual basis. Any circumstance that may involve a conflict of interest is then reported to the Board of Directors. There were no conflicts reported for the period covered by this examination.

Contracts

As of December 31, 2001, the Company was party to the following contracts:

	Effective Date
Affiliates:	
Marketing & Agency Expense Agreement –	January 1,1995
Farmers Insurance Group) -,
Income Tax Allocation Agreement	February 9, 1998
Pension Plan Administration Agreement	August 5, 1998
Non-Affiliates:	8
Systematic Business Services, Inc.	August 24, 2000
Chase Manhattan Bank Investment Custodial Agreements	December 2, 1997
State Street Bank Automated Clearing House Services	August 19, 1988

The Company allocates indirect costs based on direct costs. However, it has not filed with the OIC, for the Company's use, an agreement covering the allocation of these expenses from Farmers Group, Inc. See "INSTRUCTIONS" No. 3.

Minutes

Minutes of the meetings of the Stockholders, Board of Directors, and committees of the Board were reviewed for the period under examination. A review of the Minutes revealed significant structural changes to the Board of FNWL. All outside director positions were eliminated on April 20, 2000, and the FNWL finance committee was dissolved soon thereafter. In its place, FIG officers assumed control over FNWL's investment decisions. Financial, investment, marketing, staff operations, actuarial, MIS and insurance operation reports were always presented to the Board before its restructuring. After the Board's April 20, 2000 restructuring, reports did not appear in any minutes until July 17, 2002. See "INSTRUCTIONS" No. 1.

Capital Stock Register

FNWL has 25,000,000 shares of authorized common capital stock, of which 6,599,833 shares of \$1 par value are issued and outstanding. All shares are owned by Farmers Group, Inc. There were no stock transactions during the period under examination.

INTERNAL SECURITY

Fidelity Bonds

Farmers Group, Inc., is self-insured for fidelity losses involving employees and officers of all members of Farmers Group, Inc., including FNWL.

Other Insurance

By endorsement to its parent, the Company and its affiliates are protected against losses due to property damage, workers' compensation liability, general liability, automobile liability and directors and officers liability.

Internal Controls

The firm of Pricewaterhouse Coopers LLP, Certified Public Accountants, audited the Company's statutory financial statements for 2001. For the years 1999 and prior, the Company utilized the firm of Deloitte and Touche LLP, Certified Public Accountants. As a part of these audits, reports on internal control structure were issued with no material weaknesses noted. In addition, internal controls were independently tested by the examiners and no material weaknesses were found.

Internal Audit Function

The Company has an internal audit department that performs various tests to support and supplement the audits of the CPA. Other compliance audits are performed at the direction of management.

OFFICERS AND EMPLOYEES WELFARE AND PENSION PLANS

The Company, as a member of Farmers Group, Inc., provides its employees and their dependents with medical, dental, vision care, and life and AD&D benefits. In addition, under this program, employees have the option of paying their share of the expense of the plans with pre-tax earnings. As part of Farmers Group, Inc., the Company's employees are eligible to participate in the parent company's pension plan, a long term disability plan, and

a profit sharing savings plan. Adequate provisions were made in the financial statements for the Company's obligations under these plans.

TERRITORY AND PLAN OF OPERATION

The Company was licensed to operate in the following states as of December 31, 2001:

Alabama	Arizona	Arkansas	California	Colorado
Connecticut	Delaware	District of Columbia	Florida	Georgia
Hawaii	Idaho	Illinois	Indiana	Iowa
Kansas	Kentucky	Maine	Maryland	Massachusetts
Michigan	Minnesota	Mississippi	Missouri	Montana
Nebraska	Nevada	New Jersey	New Mexico	North Carolina
North Dakota	Ohio	Oklahoma	Oregon	Pennsylvania
Rhode Island	South Carolina	South Dakota	Tennessee	Texas
Utah	Virginia	Washington	West Virginia	Wisconsin
Wyoming		_	C	

The Company offers a portfolio of insurance products consisting primarily of traditional whole life, term life, interest sensitive whole life, flexible premium universal life policies and variable universal life policies. All business is written on a non-participating basis. Individual annuity contracts and variable annuity contracts are also available. The Company operates through the use of the Farmers Insurance Group of Companies' agency force. The Company and Farmers Group, Inc., initially entered into an agreement effective January 1, 1959, with an initial term of fifteen years and from year-to-year thereafter. That agreement was terminated as of December 31, 1994, and a new contract was entered into effective January 1, 1995.

Under the terms of the new contract, Farmers Group, Inc., will supervise, direct, and train all members of its agency force under contract with the Company to carry out its sales program. In consideration thereof, Farmers Group, Inc., dba Farmers Underwriters Association, is reimbursed monthly for marketing expenses incurred on the Company's behalf. The reimbursements are paid by the Company to Farmers Group, Inc., as soon as possible after the end of each month. Cost allocation methodologies are reviewed and approved by all parties at least annually.

Certificates of Authority were examined and found in order for all states in which the Company was admitted to do business since the date of the last examination. The Company was current in the payment of premium taxes and filing fees.

GROWTH OF COMPANY

The Company's growth is illustrated below. All information is from the Company's filed annual statements.

(000s Omitted)

Schedule I	<u>2001</u>	<u>2000</u>	<u>1999</u>	1998	1997	1996
					<u></u>	
Total Admitted Assets	\$5,628,026	\$5,099,841	\$4,736,646	\$4,301,064	\$3,974,776	\$4,468,493
Total Liabilities	4,553,367	4,009,244	3,747,031	3,412,420	3,187,139	3,808,291
Aggregate Life Reserves	3,872,755	3,710,130	3,467,349	3,187,742	2,995,796	2,791,279
Asset Valuation Reserve	22,810	45,547	62,562	33,782	29,950	37,195
Capital:						
Common stock	6,600	6,600	6,600	6,600	6,600	6,600
Preferred stock	0	0	0	0	0	0
Surplus notes	0	. 0	0	0	0	0
Gross paid in contributed capital	3,199	3,199	3,199	3,199	3,199	0
Unassigned funds	1,064,860	1,080,798	979,816	878,845	777,838	653,602
Total capital and surplus	1,074,659	1,090,597	989,615	888,644	787,637	660,202
ACL Risk Based Capital	1,097,469	1,136,144	1,052,177	922,425	817,587	697,396
Adjusted Capital	78,836	100,010	98,432	81,928	57,089	50,745

BUSINESS IN FORCE BY STATE

The Company's Direct Written Premiums for the year ended December 31, 2001:

AL	\$ 5,272,432	IA	\$5,629,821	NJ	\$526,308	VT	\$123,147
AK	372,764	KS	17,832,300	NM	15,331,871	VA	5,414,044
ΑZ	38,186,129	KY	494,014	NY	1,111,855	WA	210,637,901
AR	17,181,073	LA	700,217	NC	745,250	WV	142,115
CA	302,906,778	ME	(44,679)	ND	1,335,456	WI	13,531,088
CO	50,350,089	MD	2,456,019	OH	20,428,492	WY	4,716,322
CT	1,332,967	MA	378,353	OK	51,735,947	Other	742,489
DE	41,411	MI	12,134,827	OR	33,330,372		
DC	344,769	MN	32,260,219	PA	2,216,825		
FL	3,255,158	MS	449,492	RI	30,966		•
GA	1,348,694	MO	38,620,289	SC	391,378		
HI	748,198	MT	8,171,163	SD	4,864,998		
ID	8,096,358	NE	7,608,151	TN	8,435,183		
IL	57,905,188	NV	17,671,562	TX	166,438,237		
IN	11,169,471	NH	8,119	UT	15,903,362		

Total Direct Written Premiums by State

\$<u>1,201,014,952</u>

REINSURANCE

The Company has established retention limits for automatic reinsurance cessions. The maximum retention on new issues is \$2,000,000 per life for the Farmers Flexible Universal Life policy and \$1,500,000 per life for all traditional policies, except Farmers Yearly Renewable Term, which has a maximum retention on new issues of \$800,000 per life. The excess risk is reinsured with an unaffiliated reinsurer. When a policy is over the retention limit, the Company has the option of facultative placing of the risk with other reinsurers.

The two major types of policies that the Company has in place are a coinsurance agreement with Lincoln National and various yearly renewable term (YRT) policies with other reinsurers. The YRT policies are used by the Company to limit the risk on various products. The coinsurance agreement provides the same function but a larger portion of the risk (90%) is ceded.

A sample of reinsurance agreements was reviewed for compliance with Washington reinsurance statutes. The reinsurers were verified as being authorized to do business in Washington and were properly classified in Schedule S of the Company's 2001 Annual Statement. The Company appeared to be adequately monitoring its reinsurance program, including the financial condition of the reinsurers. The overall reinsurance program appeared to be adequate for the Company's exposure and ability to assume risk

ACCOUNTING RECORDS AND SYSTEMS

General Accounting

Daily accounting activities of the Company are performed at the Mercer Island home office. Investment transactions are prepared in Bermuda by Zurich Investment Services (ZIS). Legal services and certain processing activities for mortgage loans, real estate and expenses are completed by the parent company in Los Angeles. The financial and policy records are maintained on Farmers Group, Inc.'s mainframe computer, the Company's local area network, and personal computers.

The general ledger is maintained on the mainframe computer using the System Applications and Programs accounting system. All cash receipts and disbursements are processed using the Continuum Company, Inc.'s LIFECOMM policy administration system. Investments are maintained on the Complete Asset Management Reporting and Accounting (CAMRA) system. Work papers of the Company's internal and independent auditors were utilized where possible in testing and verifying of certain accounts.

Actuarial Opinion

The Statement of Actuarial Opinion required under RCW 48.74.025, provided by FNWL's appointed actuary, was based on an asset adequacy analysis and conforms to the specifications of WAC 284-07-380.

SUBSEQUENT EVENTS

1. Dividends

On January 14, 2002, the Company declared dividends of \$115 million to Farmers Insurance Group, Inc., without prior notification to the Washington State Insurance Commissioner's Office. RCW 48.31B.025(5)(a) states that, "Each registered insurer shall report to the commissioner all dividends and other distributions to shareholders within five business days after their declaration and at least fifteen business days before payment, and shall provide the commissioner with such other information as may be required. . ." See "INSTRUCTIONS" No. 2.

2. ZSLM Trust Notes Special Consent No. 100

On October 31, 2001, FNWL acquired securities having a par value of \$110,000,000 and accrued interest of \$2,649,839. Those securities are more specifically described as ZSLM Trust notes issued by ZSLM Trust 2000-A, a Delaware business trust (hereinafter referred to as "securities"). The investment vehicle underlying the ZSLM Trust 2000-A is notes (SMM No. 2 notes) issued by SMM No. 2 Company Limited of the United Kingdom. At the time of purchase, FNWL assumed that the securities were permitted investments pursuant to Chapter 48.13 RCW.

The securities are not currently rated by the Securities Valuation Office (SVO) of the National Association of Insurance Commissioners. The securities are not guaranteed. The investment vehicle underlying the securities is an investment in foreign securities ineligible for investment by Washington domestic insurers, without the Insurance Commissioner's special consent. On September 18, 2003, FNWL requested a rating of the securities by the SVO. On September 22, 2003, FNWL requested the Insurance Commissioner's special consent for investment in the securities.

On September 30, 2003, Special Consent No. 100 was granted to hold the above-described ZSLM Trust notes effective December 31, 2001. This special consent will be effective only until the securities have been rated by the SVO, or until December 15, 2004, whichever period is shorter. The SVO rating of the securities will be determinative of the future application of Chapter 48.13 RCW to the securities.

The investments authorized by this Order shall be eligible for classification as admitted assets of FNWL and may be credited to FNWL's minimum capital or surplus or required reserves pursuant to RCW 48.13.250. See "INSTRUCTIONS" No. 5.

3. Foreign Securities Special Consent No. 102

FNWL has a current investment (as of December 31, 2001) of approximately \$69,000,000 in securities of foreign governments and foreign corporations (that is, where the issuing company is incorporated outside the United States). This amount has fluctuated over the past years. FNWL made these investments under the belief that these were permitted under RCW 48.13.240. FNWL had interpreted RCW 48.13.180 as providing only for special limits for two specific categories of foreign investments. This meant that investments in foreign securities other than those within those two categories were subject to the limits of RCW 48.13.240. The OIC believes that foreign investments are limited to those categories described in RCW 48.13.180.

FNWL desires to be in compliance with the OIC's interpretation of the Code, and sought special consent to hold the foreign securities as admitted assets until December 31, 2003, when at such time the Company will maintain the revised standard of eligibility contained in RCW 48.13.180. The Insurance Commissioner finds that FNWL's proposal to hold its investments in foreign securities totaling \$69 million is reasonable, in the best interest of FNWL and its policyholders, and will not impair the ability of FNWL to meet its financial obligations to its policyholders. Therefore, the special consent to acquire and hold these investments in excess of the limitations contained in RCW 48.13.030 and RCW 48.13.180 was granted effective December 31, 2001. The investments authorized by this Order may be credited to FNWL's minimum capital or surplus or required reserves pursuant to RCW 48.13.250. See "INSTRUCTIONS" No. 4.

FINANCIAL STATEMENTS

The following statements, with the exception of the Five Year Capital and Surplus Reconciliation, reflect the financial condition of the Company as of December 31, 2001, as determined by this examination:

STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS STATEMENT OF SUMMARY OF OPERATIONS STATEMENT OF CAPITAL AND SURPLUS ACCOUNT STATEMENT OF FIVE YEAR CAPITAL AND SURPLUS RECONCILIATION

ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS As of December 31, 2001

		BALANCE PER	EXAM	BALANCE PER
ASSETS	NOTES	COMPANY	ADJUSTMENTS	EXAMINATION
Bonds	(1)	\$3,892,430,584		3,892,430,584
Stocks:				
Preferred Stocks	(2)	32,497,056		32,497,056
Common Stocks	(3)	262,911,123		262,911,123
Mortgage Loans on Real Estate	(4)	28,900,636		28,900,636
Real Estate:				,
Properties Occupied by the Company		9,432,947		9,432,947
Properties Held for the Production of Inc	come	76,655,842		76,655,842
Properties Held for Sale		1,098,320		1,098,320
Policy Loans	(5)	232,286,966		232,286,966
Cash on Hand & on Deposit		4,960,088		4,960,088
Short-Term Investments	(6)	163,000,372		163,000,372
Other Invested Assets		502,935,300	•	502,935,300
Receivable for Securities		119,000,000		119,000,000
Aggregate Write-ins for Invested Assets		12,689,731		12,689,731
Subtotals, Cash & Invested Assets		5,338,798,965	0	5,338,798,965
Reinsurance Ceded:				<u> </u>
Amounts Recoverable from Reinsurers		4,509,200		4,509,200
Commissions & Expense Allowances Du	ıe	59,922		59,922
Experience Rating & Other Refunds Due	2	37,268		37,268
Electronic Data Processing Equipment		1,572,950		1,572,950
Federal Income Tax Recoverable		10,367,440		10,367,440
Guaranty funds Receivable or on Deposit		304,812		304,812
Life Ins Prems & Annuity Considerations D	ef & Uncollected	136,224,333		136,224,333
Accident & Health Premiums Due & Unpaid	i	1,824		1,824
Investment Income Due & Accrued		59,659,860		59,659,860
Receivable from Parent, Subsidiaries & Affi	liates	2,778,667		2,778,667
Aggregate Write-Ins for Other Than Investe		20,585,643		20,585,643
Total Assets Excluding Separate Accounts I		5,574,900,884		5,574,900,884
From Separate Accounts Statement	(7)	53,125,976	· ·	53,125,976
Total Assets	• /	\$5,628,026,860	\$0	\$5,628,026,860
				30,000,000

ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS As of December 31, 2001

LIABILITIES, SURPLUS & OTHER FUNDS	NOTES	BALANCE PER COMPANY	EXAM ADJUSTMENTS	BALANCE PER EXAMINATION
Aggregate Reserve for Life Policies & Contracts		\$3,872,755,350		\$3,872,755,350
Aggregate Reserve for Accident & Health Policies		379,537		379,537
Liability for Deposit-Type Contracts		343,878,259		343,878,259
Policy & Contract Claims:				, ,
Life		32,249,946		32,249,946
Accident & Health		4,100		4,100
Premiums & Annuity Considerations Received in Adva-	nce	1,587,150		1,587,150
Policy & Contract Liabilities Not Included Elsewhere:				
Provision for Experience Rating Refund				
Interest Maintenance Reserve	(8)	51,587,339		51,587,339
Commissions to Agents Due & Accrued		1,475,224		1,475,224
Commissions & Expenses Allowances on Reinsurance	Assumed	37,989		37,989
General Expenses Due or Accrued		11,936,242		11,936,242
Transfer to Separate Accounts Due or Accrued		(5,678,205)		(5,678,205)
Taxes, Licenses & Fees Due or Accrued		4,968,751		4,968,751
Federal Income Taxes Due or Accrued		371,783		371,783
Unearned Investment Income		862,713		862,713
Amounts Withheld or Retained by Company as Agent of	or Trustee	652,562		652,562
Amounts Held for Agents' Account		5,678,732		5,678,732
Remittances & Items Not Allocated		33,546,652		33,546,652
Asset Valuation Reserve	(9)	22,810,316		22,810,316
Payable for Securities		107,000,000		107,000,000
Aggregate Write-ins for Liabilities		14,136,895	0	14,136,895
Total Liabilities Excluding Separate Accounts Busin	ess	4,500,241,335		4,500,241,335
From Separate Accounts Statement	_	53,125,976	0	53,125,976
Total Liabilities	-	4,553,367,311	0	4,553,367,311
Common Capital Stock		6,599,833		6,599,833
Gross Paid in and Contributed Surplus		3,199,470		3,199,470
Unassigned Funds	-	1,064,860,246		1,064,860,246
Total Surplus		1,074,659,549	0	1,074,659,549
Total Liabilities, Surplus & Other Funds	=	\$5,628,026,860	\$0	\$5,628,026,860

SUMMARY OF OPERATIONSFor the Year Ended December 31, 2001

	BALANCE PER COMPANY	BALANCE PER EXAMINATION
Premiums & Annuity Considerations	\$943,381,771	\$943,381,771
Net Investment Income	333,664,970	333,664,970
Amortization of Interest Maintenance Reserve	6,631,115	6,631,115
Commissions & Expense Allowances on Reinsurance Ceded	25,647,398	25,647,398
Miscellaneous Income:		
Income From Fees Associated with Inv Management	453,660	453,660
Charges and fees for Deposit-Type Contracts	97,689	97,689
Aggregate Write-Ins for Miscellaneous Income	1,969,343	1,969,343
Totals	1,311,845,946	1,311,845,946
Death Benefits	137,178,875	137,178,875
Matured Endowments	428,324	428,324
Annuity Benefits	294,375,400	294,375,400
Disability Benefits & Benefits Under Accident & Health Policies	2,063,445	2,063,445
Coupons, Guaranteed Annual Pure Endowments and Similar Benefits	3,434,661	3,434,661
Surrender Benefits & Other Fund Withdrawals	63,706,618	63,706,618
Group Conversions	42,679	42,679
Interest on Policy or Contract Funds	101,229,341	101,229,341
Payments on Supplementary Contracts with Life Contingencies	27,041	27,041
Increase in Agg Reserve for Life & Accident & Health & Policy Contracts	278,104,371	278,104,371
Totals	880,590,755	880,590,755
Commissions on Prem, Annuity Considerations & Deposits-Type	87,706,186	87,706,186
Commissions & Expense Allowance on Reinsurance Assumed	166,724	166,724
General Insurance Expenses	95,442,342	95,442,342
Insurance Taxes, Licenses & Fees, Excluding Federal Income Taxes	14,697,794	14,697,794
Increase in Loading on Deferred & Uncollected Premiums	(2,415,122)	(2,415,122)
Net Transfers to or (from) Separate Accounts	42,479,188	42,479,188
Aggregate Write-ins for Deductions	659,579	659,579
Totals	1,119,327,446	1,119,327,446
Net Gain from Operations Before Federal Income Taxes	192,518,500	192,518,500
Federal Income Taxes Incurred (Excluding Capital Gains Tax)	56,191,115	56,191,115
Net Gain from Operations Before Capital Gains or (Losses)	136,327,385	136,327,385
Net Realized Capital Gains or (Losses) Less CG Tax & Transferred to IMR	(101,925,492)	(101,925,492)
Net Income	\$34,401,893	\$34,401,893

CAPITAL AND SURPLUS ACCOUNTFor the Year Ended December 31, 2001

CAPITAL & SURPLUS ACCOUNT	BALANCE PER COMPANY	EXAM ADJUSTMENTS	BALANCE PER EXAMINATION
Capital & Surplus, December 31, Previous Year	\$1,090,597,036		\$1,090,597,036
Net Income	34,401,893		34,401,893
Change in Net Unrealized Capital Gains or (Losses)	17,457,133		17,457,133
Change in Net Deferred Income Tax	(5,171,288)		(5,171,288)
Change in Non-Admitted Assets & Related Items	21,465,751		21,465,751
Change in Asset Valuation Reserve	22,737,175		22,737,175
Cumulative Effect of Changes in Accounting Principal	5,171,849		5,171,849
Dividends to Stockholders	(112,000,000)		(112,000,000)
Net Change in Capital & Surplus for the Year	(15,937,487)	0	(15,937,487)
Capital & Surplus, December 31, Current Year	\$1,074,659,549	\$0	\$1,074,659,549

FIVE-YEAR CAPITAL AND SURPLUS RECONCILIATION

	2001	2000	<u>1999</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
Capital and Surplus Dec. 31 Previous Year Net Income Change in Net Unrealized Capital Gains Change in Deferred Income Tax	\$ 1,090,597,036 34,401,893 17,457,133 (5,171,288)	\$ 989,615,205 134,755,646 (43,089,384)	\$ 888,643,951 114,909,283 15,697,643	\$ 787,637,365 98,796,046 6,930,831	\$ 660,201,821 122,863,064 (3,066,298)	\$ 861,585,357 160,957,111 (45,673,652)
Change in Non-Admitted Assets Change in Reserve/Change in Valuation	21,465,751	(12,774,984) 5,075,978	(855,381)	(888,859)	394,161	(176,850)
Change in Asset Valuation Reserve Cumulative Effect Change in Acct Principles Surplus adjustment	22,737,175 5,171,849	17,014,575	(28,780,291)	(3,831,432)	7,244,617	58,425,841
Paid in Dividend to Stockholders Aggregrate Write-Ins for Gain/Loss in Surplus	(112,000,000)		·		3,199,470 (3,199,470)	(374,915,986)
Net Change in Capital and Surplus for Year	(15,937,487)	100,981,831	100,971,254	101,006,586	127,435,544	(201,383,536)
Capital and Surplus Dec. 31 Current Year	\$ 1,074,659,549	\$ 1,090,597,036	\$ 989,615,205	\$ 888,643,951	787,637,365	\$ 660,201,821

NOTES TO FINANCIAL STATEMENTS

1. Bonds

Bond values were generally stated at amortized cost using the scientific method. Collateralized Mortgage Obligations (CMO's) and other loan backed bonds were valued at amortized cost using the scientific method with an adjustment for anticipated prepayments at the date of purchase. Any significant change in the estimated cash flows from the original purchase assumptions were accounted for using the retrospective method except for high risk securities that used the prospective method. The Company's investment in bonds represented (69.2%) of its general account admitted assets. The bond portfolio consisted of the following:

	Statement	Par	Market
Classification	<u>Value</u>	<u>Value</u>	V alue
U.S. Government	\$283,493,950	\$261,529,610	\$282,245,158
Foreign	19,938,216	20,000,000	20,141,200
Governments			
Municipalities	33,478,909	33,280,000	34,582,917
Revenue Bonds	1,240,469,515	1,246,171,181	1,249,639,857
Public Utilities	58,257,425	58,049,632	59,980,608
Industrial & Misc.	2,256,792,569	2,293,214,409	3,918,910,522
Total	\$3,892,430,584	\$3,912,244,832	\$3,912,244,832

2. Preferred Stocks

Preferred stock values were stated at the lower of amortized cost or market in accordance with the NAIC Valuation of Securities Manual and the applicable sections of the Washington Insurance Code.

Preferred stocks represented .58% of the Company's general account admitted assets. The preferred stock portfolio consisted of the following:

		Statement	Market	
Classification	Book Value	<u>Value</u>	<u>Value</u>	Actual Cost
Public Utilities	\$22,522,356	\$22,522,356	\$22,492,403	\$23,200,800
Industrial & Misc., U.S.	9,974,700	9,974,700	11,075,000	9,974,700
Total	\$32,497,056	\$32,497,056	\$33,567,403	\$33,175,500

3. Common Stock

Common stock values were stated at market in accordance with the NAIC Valuation of Securities Manual and the applicable sections of the Washington Insurance Code.

Common stocks represent 4.7% of the Company's general account admitted assets. The common stock portfolio consisted of the following:

Classification	Book Value	Market	Actual Cost
		<u>Value</u>	
Public Utilities	\$12,422,404	\$12,422,404	\$13,519,547
Banks, Trusts & Insurance	37,805,531	37,805,531	38,924,130
Industrial & Misc.	212,683,188	212,683,188	261,023,851
Total	\$262,911,123	\$262,911,123	\$313,467,528

4. Mortgage Loans

Mortgage loan values were stated at the aggregate unpaid balance in accordance with the NAIC Accounting Practices and Procedures Manual.

5. Policy Loans

Policy loan values were stated at the aggregate unpaid balance in accordance with the NAIC Accounting Practices and Procedures Manual.

6. Short Term Investments

Short term investment values were stated at amortized cost in accordance with the NAIC Accounting Practices and Procedures Manual.

7. Separate Accounts

Prior to 1997, the Company administered the pension fund assets for the entire Farmers Group, Inc., and segregated FGI assets in the separate accounts. Beginning in 1997, FGI administered the pension plan and its Investment Committee manager became responsible for maintaining, acquiring and disposing of plan assets. Beginning in the year 2000, the Company sold new variable universal life and variable annuity products which were indexed to the stock market through mutual fund arrangements. The assets were required to be segregated to track performance and transfer risk to policyholders. As of December 31, 2000 and 2001, the Company listed \$8,422,901 and \$53,125,976, respectively as segregated assets.

8. Interest Maintenance Reserve

The interest maintenance reserve was calculated in accordance with the instructions provided by the Securities Valuation Office of the NAIC. The purpose of the reserve is to stabilize the Company's net income from the effect of net realized capital gains related to interest rate fluctuations since the date of original acquisition.

9. Asset Valuation Reserve

The asset valuation reserve was calculated in accordance with the instructions provided by the Securities Valuation Office of the NAIC. The purpose of the reserve is to safeguard the Company's surplus from the effect of investments whose quality has deteriorated and unrealized losses not eligible for amortization.

ACKNOWLEDGEMENT

The cooperation and assistance of the officers and employees of the Company during the examination are hereby acknowledged.

John Gaynard, AFE, CPA, Reinsurance Specialist; Susan Campbell, CPA, FLMI; Kathy Hicks, CPA; Alexis S. Santos, FSA, MAAA, Associate Actuary; Timothy F. Hays, CPA, JD, Investment Specialist; and John R. Jacobson, AFE, IS Specialist; all from the Washington State Insurance Commissioner's Office, participated in the examination and the preparation of this report.

Respectfully submitted,

Michael V. Jordan, CPA CFE, MHP

Examiner-in-Charge

Washington State Office of the Insurance Commissioner

Timothy Gadler, CFE

Representing State of Nevada and NAIC Western Zone

Richard Randour, CFE, CPA

Representing State of Delaware and NAIC Northeastern Zone

AFFIDAVIT OF EXAMINER IN CHARGE

STATE OF WASHINGTO		
) s:	
COUNTY OF KING)	

I, Michael Jordan, being duly sworn, depose and say that the foregoing report subscribed by me is true to the best of my knowledge and belief.

I attest that the examination of Farmers New World Life Insurance Company was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).

Subscribed and sworn to before me on this 23rd day of February, 2004.

Notary Public in and for the State of Washington, residing

at Seattle.

My commission expires \mathcal{H}